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Arizona Corporation Commission

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1 QUARLES & BRADY STREICH LANG LLP

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7 Donald J. Karl (019841)

8 Attorneys for Arthur Andersen LLP

9 **BEFORE THE ARIZONA CORPORATION COMMISSION**

10  
11  
12 IN THE MATTER OF:

13 ARTHUR ANDERSEN LLP

14 501 North 44th Street - 300

Phoenix, Arizona 85008

15 Respondent.

DOCKET NO. S-03386A-00-0000

**RESPONDENT'S MOTION TO  
DECLINE JURISDICTION**

(Assigned to the Honorable Marc E. Stern)

**(Oral Argument Requested)**


16  
17 Pursuant to Rules R14-3-101(A) and R14-3-105(K), Arizona Administrative Code,  
18 respondent Arthur Andersen LLP, ("Arthur Andersen") moves the Arizona Corporation  
19 Commission ("Commission") to exercise its discretion and decline to hear the allegations in this  
20 matter for several reasons, including the fact that the Commission and the Securities Division  
21 ("Division") have a conflict of interest in pursuing this matter. This Motion is supported by the  
22 attached Memorandum of Points and Authorities.

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DATED this 27 day of November, 2000.

QUARLES & BRADY STREICH LANG LLP  
Renaissance One  
Two North Central Avenue  
Phoenix, Arizona 85004-2391

By



Don P. Martin  
Edward F. Novak  
Donald J. Karl

Attorneys for Arthur Andersen LLP

1                                   **MEMORANDUM OF POINTS AND AUTHORITIES**

2   **I.       INTRODUCTION**

3           On September 27, 2000, the Division filed an administrative action with the Commission  
4 in the wake of the financial collapse of the Baptist Foundation of Arizona ("BFA") alleging that  
5 Arthur Andersen committed various securities law violations. However, the Division's  
6 allegations and demands for relief closely mirror several existing investor lawsuits that are  
7 pending in state and federal court. A hearing before the Commission will unnecessarily  
8 duplicate existing judicial efforts.

9           In addition, the Division and the Commission themselves may have contributed to the  
10 investors' losses by not adequately investigating BFA's securities sales after receiving an  
11 investor complaint in 1992. Consequently, the Commission is an inappropriate forum in which  
12 to resolve the claims raised by the Division. In its discretion, the Commission should decline  
13 to hear the allegations in this matter.

14   **II.     THE COMMISSION SHOULD EXERCISE ITS DISCRETION AND DECLINE**  
15       **TO HEAR THE DIVISION'S ALLEGATIONS AGAINST ARTHUR ANDERSEN.**

16       **A.     The Commission May Decline To Hear The Division's Allegations If Sound**  
17                   **Reasons Exist To Do So.**

18           The Commission has broad authority to enforce Arizona's securities laws. See Ariz. Rev.  
19 Stat. Ann. ("A.R.S.") §§ 44-1822 (1994) (authorizing public and private investigations to  
20 uncover securities law violations), 44-2032 (Supp. 1999) (giving the Commission power to issue  
21 cease and desist orders and award restitution for certain securities law violations), 44-2036  
22 (1994) (giving the Commission power to assess administrative penalties for certain securities  
23 law violations). The Commission also enjoys broad discretion to determine how and when to  
24 exercise this authority. See A.R.S. §§ 44-1822 (allowing the Commission to conduct  
25 investigations "as [it] deems necessary"), 44-2036 (specifying that the Commission may assess  
26 administrative penalties for certain securities law violations; A.R.S. § 44-2032 (leaving

1 enforcement decisions to the Commission's discretion). Similarly, the Commission enjoys  
2 discretionary authority to conduct hearings as part of an enforcement effort. See A.R.S. § 44-  
3 1971 (1994). Thus, in its discretion, the Commission may decline to hear allegations of securities  
4 law violations when sound reasons exist to do so.

5 **B. Sound Reasons Exist For The Commission To Decline To Hear The**  
6 **Division's Allegations Against Arthur Andersen.**

7 The Commission should decline to hear the Division's allegations against Arthur  
8 Andersen for at least two reasons. First, a hearing before the Commission will unnecessarily  
9 waste both administrative and judicial resources. Second, the Commission has a conflict of  
10 interest in this matter by virtue of the Division's delay in seeking an order to stop the sale of  
11 BFA's securities and taking appropriate action. Consequently, the Commission cannot hear this  
12 matter unimpeded by a perception of impropriety and flawed rulings.

13 **1. A Commission hearing will waste scarce administrative and judicial**  
14 **resources.**

15 BFA's investors already have a putative class action lawsuit in state court alleging that  
16 Arthur Andersen violated Arizona's securities laws. See Grant, et al. v. Arthur Andersen LLP,  
17 et al., No. CV 99-19093 (Maricopa County Super. Ct., amended complaint filed Feb 18,  
18 2000) ("Grant FAC").<sup>1</sup> The Division's allegations against Arthur Andersen closely parallel the  
19 investors' allegations against Arthur Andersen in Superior Court. For example:

- 20 ▶ Both allege that Arthur Andersen ignored "red flags" that should have alerted it to  
21 BFA's financial woes.
- 22 ▶ Both allege that BFA was engaged in a ponzi scheme.
- 23 ▶ Both allege that Arthur Andersen did not conduct its audits of BFA's financial  
24 statements in accordance with generally accepted auditing standards.

25 <sup>1</sup> Some sixty (60) other BFA investors have also filed a federal lawsuit against Arthur  
26 Andersen and others arising out of the same transactions and occurrences and alleging the same  
state securities law violations that appear in the Division's allegations. See Bartlett, et al. v.  
Arthur Andersen LLP, et al., No. CIV 00-0852 PHX SMM (D. Ariz. amended complaint filed  
Aug. 7, 2000). The allegations in Bartlett are nearly identical to those in Grant.

- 1       ▶ Both allege that Arthur Andersen materially misrepresented BFA's financial condition.
- 2       ▶ Both allege that Arthur Andersen had inside information about BFA's allegedly fraudulent practices.
- 3       ▶ Both allege that Arthur Andersen failed to take appropriate action after BFA's financial troubles were disclosed by the Phoenix New Times ("New Times").
- 4       ▶ Both allege that Arthur Andersen aided and abetted BFA's purported securities violations.
- 5       ▶ Both allege that Arthur Andersen participated in or induced BFA's purportedly illegal securities sales.
- 6
- 7

8       Compare Grant FAC, at ¶¶ 32-37, 68-88, with Notice Of Opportunity For A Hearing Regarding  
9       Proposed Order To Cease And Desist, For Restitution, For Administrative Penalties And For  
10       Other Relief, In the matter of Arthur Andersen LLP, Docket No. S-03386A-00-0000, at ¶¶ 6-8,  
11       40-82 (Ariz. Corp. Comm'n filed Sept. 27, 2000) ("Notice"). In addition, the Division and the  
12       investors each have described in very similar terms the underlying fraud allegedly committed by  
13       BFA and its related entities. Compare Grant FAC, at ¶¶ 38-55, with Notice, at ¶¶ 30-38.

14       The remarkable similarities between the Division's administrative action and the  
15       investors' state lawsuit extend even to the relief sought. The Division has requested that the  
16       Commission order Arthur Andersen to cease and desist from violating the securities laws, pay  
17       restitution, and pay administrative penalties of up to five thousand dollars per securities law  
18       violation, as well as award "any other relief that the Commission deems appropriate." Notice,  
19       at ¶¶ 1-4. For their part, the investors have asked for compensatory and treble damages that  
20       include restitution, interest, costs and fees, and "[s]uch other and further relief as the Court  
21       deems just and proper." Grant FAC, at ¶ 158. The "other and further relief" could include an  
22       injunction and an award of civil penalties to the state that virtually would match any cease and  
23       desist order or administrative penalties that the Commission might impose. See A.R.S. § 44-  
24       2005 (1994) (preserving all statutory and common law rights for litigants involved in a securities  
25  
26

1 action in court); A.R.S. § 44-2037 (1994) (establishing civil penalties of not more than five  
2 thousand dollars per securities law violation). Thus the two actions are essentially redundant.

3 Because the Division's administrative action so closely mirrors the investors' lawsuit, a  
4 hearing before the Commission will unnecessarily duplicate and waste scarce public resources.  
5 Both actions arise out of the same transactions and occurrences, raise similar allegations, and  
6 demand similar relief. Importantly, whether by court or Commission order, restitution can be  
7 obtained for the investors only once. Therefore, a hearing before the Commission must cover  
8 the same ground that will be covered in superior court, in federal court, or both, but will result  
9 in no greater remedy for the investors than they already seek for themselves.

10 The discovery that will be conducted before any Commission hearings can occur will  
11 duplicate the discovery in state and federal court. A staggering amount of documentary evidence  
12 may be introduced at any Commission hearing—the same evidence that would be offered in state  
13 and federal court. The Division already has nearly one hundred boxes of BFA documents in its  
14 possession as well as more than seventy boxes of Arthur Andersen documents. Forcing the  
15 parties, the superior court, the federal court, and the Commission to manage the same large  
16 volume of documentary evidence in multiple proceedings, as well as the testimonial evidence,  
17 that necessarily will accompany them will waste the resources of the Commission and the courts  
18 and unnecessarily compound the litigation expenses of this unfortunate situation.<sup>2</sup>

19 To make matters worse, the Division's administrative hearing will tie up the Commission  
20 for an extended period of time. The Division has said that it may need as much as two months'  
21 time to put on its case. That estimate is quite low. Moreover, Arthur Andersen of necessity must  
22 defend itself against all of the Division's allegations and may need as much time or more to put  
23

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24 <sup>2</sup> Counsel for the plaintiffs in the state court actions have expressed a need to coordinate  
25 discovery in light of the enormity of the task. Arthur Andersen is not opposed to coordinated  
26 discovery in state court.

1 on its defense. At the same time, Arthur Andersen will be embroiled in its defense of the  
2 investors' lawsuits and other litigation spawned by BFA's financial collapse.<sup>3</sup> Lawyers and  
3 witnesses cannot be in two places at the same time, and so the Commission and the courts  
4 necessarily will have to coordinate their proceedings, further extending the amount of time  
5 needed to resolve any of these actions. Obviously, while a Commission hearing officer and  
6 hearing room are tied up with this matter, other Commission business will be delayed.

7 Add to this the possibility of inconsistent rulings on evidentiary privilege and other  
8 procedural, as well as substantive, matters. It makes sense that rather than devote its resources  
9 to such wasteful and unnecessary duplication, the Commission prudently should decline to hear  
10 this matter. The Division is not bound to seek relief from the Commission. It can take its case  
11 to superior court. See A.R.S. § 44-2031 (1994) (vesting the superior court with jurisdiction of  
12 securities law violations and offenses); A.R.S. § 44-2037(B) (allowing the attorney general to  
13 bring a court action "in the same manner as the filing of other such actions"). There, the  
14 Division may seek coordinated discovery on its claims and those of the investors or possibly  
15 even consolidation of its claims for relief with those of the investors.

16 The superior court is far better suited to deal with matters this complex and time  
17 consuming. It has more judges, more courtrooms, more support staff, and more filing capacity  
18 than does the Commission. A large and complex case such as this will have far less disruptive  
19 impact on other matters pending in superior court than it will on matters pending before the  
20 Commission. Requiring the Division to pursue its complaint in superior court frees the  
21 Commission to apply its resources to the matters that it alone can address, and to matters that it  
22 can address most efficiently.

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25 <sup>3</sup> In addition to the Division's administrative action and the investor lawsuits, BFA itself  
26 has sued Arthur Andersen in state court. See BFA v. Arthur Andersen, No. CV2000-015849  
(Maricopa County Super. Ct. filed Aug. 25, 2000).

1                   **2.     The Commission should decline to hear this matter because of its own**  
2                   **conflict of interest.**

3           The Commission should decline to hear this matter because of the likelihood that any  
4 Commission rulings will be tainted by an apparent conflict of interest in now pursuing a case that  
5 it left unattended for years. Although the Commission is an administrative body, "due process  
6 requires that all parties appearing before it receive a 'fair and impartial decision.'" Evertsen v.  
7 Industrial Comm'n, 117 Ariz. 378, 383, 573 P.2d 69, 74 (Ct. App. 1977). As the Evertsen court  
8 explained:

9           What is "fair and impartial," like beauty, is mainly in the eyes of the beholder.  
10          Thus, if an adjudicatory tribunal "appears" to be favoring one side or the other  
11          regardless of the justness of its decision, the losing party is going to assume that  
12          the decision is biased. The result is that not only is the decisional process of the  
13          tribunal brought into disrepute, the reviews of that tribunal naturally increase,  
14          burdening the entire system. In short, like Caesar's wife, an adjudicating tribunal  
15          must avoid even the appearance of impropriety in dealing with adverse interests  
16          appearing before it.

17          *Id.* Thus, unless the law requires otherwise, the Commission should decline to hear a matter  
18 brought before it if a conflict of interest will undermine the result.

19          The timing of the Commission's investigation into BFA's alleged fraud, the inordinate  
20 delay in pursuing that investigation, and the concomitant investor losses during the delay will  
21 cast a cloud on any hearing before the Commission. In its recitation of facts, the Division  
22 claimed that Arthur Andersen ignored "an increasing number of significant warning signs that  
23 [BFA management] was perpetrating a financial fraud," as well as "disturbing information" from  
24 a former BFA employee that confirmed what these warnings signs indicated. Notice at ¶ 6. The  
25 Division noted that a series of investigative articles appearing in the Phoenix New Times in  
26 April 1998 also contained "serious allegations of fraud and insider dealings" against BFA's  
senior management. Notice, at ¶ 71. According to the Division, Arthur Andersen did not change  
its audit approach in the face of this information and, consequently, did not seriously and

1 meaningfully address “the evidence of financial improprieties.” *Id.* at ¶ 7; *see id.* at ¶¶ 71-79.  
2 Thus, in the Division’s view, Arthur Andersen “facilitated the perpetuation of the fraud and the  
3 cover-up of the fraud.” *Id.* at ¶ 80.

4 The Division admits in its Notice that BFA’s senior management intentionally hid “the  
5 precarious financial condition of BFA . . . to the great detriment of investors.” Notice at ¶ 32.  
6 These same senior managers who were intent on hiding BFA’s financial condition from investors  
7 controlled the information base for Arthur Andersen’s audits. Cf. Bily v. Arthur Young & Co.,  
8 834 P.2d 745, 762 (Cal. 1992) (“An auditor is a watchdog, not a bloodhound. As a matter of  
9 commercial reality, audits are performed in a client-controlled environment.”) In such an  
10 environment, no auditor can be expected to detect every fraudulent intent. See id. at 763 (“Using  
11 different initial assumptions and approaches, different sampling techniques, and the wisdom of  
12 20-20 hindsight, few CPA audits would be immune from criticism.”). But, viewing the situation  
13 with the benefit of hindsight, the Division argues that Arthur Andersen should have done  
14 something more.

15 To find any credit in this argument, the Commission and the Division must admit that they  
16 themselves should have done more. In 1992, the Division and the Commission received a  
17 written complaint from a BFA investor alerting them to BFA’s secretive and suspicious  
18 activities. (ex.1, attached). The Commission had the investigative power to compel production  
19 of documents and witnesses and force BFA’s senior management to disclose what they  
20 intentionally hid from BFA’s board and investors. See A.R.S. § 44-1823 (1994) (granting the  
21 Commission the power to require testimony and production of records). But the Division and  
22 the Commission failed to respond in a timely manner and the Division dropped its investigation.

23 In December 1998, the Phoenix New Times reported that finally, after eight years, the  
24 Division was assisting the Arizona Attorney General’s criminal investigation into the allegations  
25 against BFA. See Terry Greene Sterling, Poring a Foundation: State prosecutors, regulators  
26

1 scrutinize the Baptist Foundation of Arizona, Phoenix New Times, Dec. 10, 1998, available in  
2 Lexis, NEWS Library, PHNXNT File (ex. 2, attached). Yet nearly a year passed before the  
3 Commission issued a cease and desist order, all the while knowing investors were rolling over  
4 existing investments and making new investments. See Max Jarman, 1st Probe Came Up  
5 Empty; New Investigation Finds Troublesome Transactions, Arizona Republic, Oct. 13, 1999,  
6 available in Lexis, NEWS Library, AZREP File (ex. 3, attached).

7       It appears that the Division's own investigation produced little until only recently.  
8 Regrettably, it appears that the Commission allowed BFA to continue selling securities for over  
9 seven years after the first complaint and nearly sixteen months after the first public report in the  
10 New Times of BFA's alleged financial misdealing.

11       The seven-year delay between the Division's initial investigation and the Commission's  
12 cease and desist order cannot be ignored. It may well indicate negligence on the part of  
13 Commission employees. Whether negligent or not, the Division's and the Commission's own  
14 conduct towards BFA suggest an unavoidable conflict in the Division's belated effort to pin  
15 Arthur Andersen with BFA's losses.

16       The Commission and the Division are fully aware of their exposure for the misfeasance  
17 or negligence of their employees. See generally State v. Superior Ct., 123 Ariz. 324, 599 P.2d  
18 777 (1979), overruled on other grounds, State v. Gunnison, 127 Ariz. 110, 113, 618 P.2d 604,  
19 607 (1980). By pursuing Arthur Andersen now before the Commission, it appears they are  
20 attempting to deflect attention and criticism for their failure to effectively pursue BFA in 1992.

21       If the Commission finds Arthur Andersen blameworthy, then it will appear to hold Arthur  
22 Andersen to a standard of conduct different than that to which it holds itself and its employees.  
23 If not, then the Commission will appear to have exonerated Arthur Andersen in order to avoid  
24 calling its own and the Division's conduct into question. Either way, the Commission cannot  
25 hear this matter and sidestep its conflict.

1 **III. CONCLUSION**

2 For the foregoing reasons, Arthur Andersen moves the Commission to decline to proceed  
3 to a hearing on the Division's allegations.

4 RESPECTFULLY SUBMITTED this 27 day of November, 2000.

5 QUARLES & BRADY STREICH LANG LLP  
6 Renaissance One  
7 Two North Central Avenue  
8 Phoenix, Arizona 85004-2391

9 By 

10 Don P. Martin  
11 Edward F. Novak  
12 Donald J. Karl

13 Attorneys for Arthur Andersen LLP

14 ORIGINAL AND TEN COPIES of the foregoing  
15 delivered this 27th day of November, 2000 to:

16 ARIZONA CORPORATION COMMISSION  
17 Docket Control Center  
18 1200 West Washington Street  
19 Phoenix, AZ 85007-2996

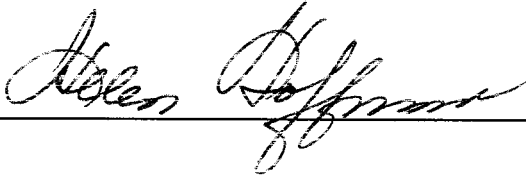
1 COPY of the foregoing delivered  
2 this 27th day of November, 2000, to:

3 Honorable Marc E. Stern  
4 Hearing Officer  
5 ARIZONA CORPORATION COMMISSION  
6 1200 West Washington  
7 Phoenix, AZ 85007

8 COPY of the foregoing faxed and mailed  
9 this 27th day of November, 2000 to:

10 Jennifer A. Boucek, Esq.  
11 ARIZONA ATTORNEY GENERAL'S OFFICE  
12 1275 West Washington Street  
13 Phoenix, AZ 85007

14 LeRoy H. Johnson, Esq.  
15 Securities Division  
16 ARIZONA CORPORATION COMMISSION  
17 1300 West Washington Street  
18 Phoenix, AZ 85007

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# **EXHIBIT 1**

COMPLAINT FORM  
(PLEASE TYPE OR PRINT IN BLACK INK ONLY)

<p>State Name and Address of FIRM OR PERSON Complained Against</p> <p><u>*Baptist Foundation of Arizona</u></p> <p><u>1313 E. Osborn Rd., #250</u></p> <p><u>Phoenix, Az.</u></p> <p><u>P.O. Box 33339</u>      <u>Zip: 85067</u></p> <p><u>*AKA BFA</u></p> <p><u>Phone 602 279-3587</u></p>	<p>State YOUR Name and Address</p> <p><u>David S. Moore</u></p> <p><u>450 Finney Circle</u></p> <p><u>Prescott, Az.</u></p> <p>_____ <u>Zip 86303</u></p> <p>Home</p> <p><u>Phone: 602 776-9407</u></p> <p>Business</p> <p><u>Phone: _____</u></p>
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Type of Complaint:

- (xx) Complaint against a Company  
( ) Complaint against an individual  
( ) Other. Please Specify: \_\_\_\_\_

Date of Transaction: Deposit account. See page 3.

Did you receive any papers or documents? (x) Yes ( ) No  
(If Yes, please attach copies of them.)

State the type of investment (e.g., stock, note, limited partnership, etc. If you are not certain, describe on last page):  
Five-yr. mortgage-backed note, 9½%, due 10/96, \$3,274.42  
Seven-yr. mortgage backed note, 12%, due 4/97, \$4,085.39

-If you invested in stock or bonds, what was the name of the  
issuing corporation? \_\_\_\_\_

-If you invested in a note, who was the maker (company or  
individual) responsible for paying it? Arizona Southern Baptist  
New Church Ventures, Inc.

-If you invested in a partnership, what was the name of that  
partnership? \_\_\_\_\_

How did you first learn about this investment opportunity?

Baptist Foundation of Arizona advertisement

Amount involved in transaction: \$7,359.81

Place of Transaction (specify states in which you and the salesperson were located): Arizona

Were there other witnesses to the transaction?: Wife

Name of salesperson: Carroll Burdick

Did you tape-record any of your conversations regarding the transaction? ( )Yes (x)No

May we send a copy of your complaint to the firm or individual complained against? (x)Yes ( )No

Do you have an attorney? ( )Yes (x)No. If Yes, give attorney's name and address \_\_\_\_\_

Did you begin any legal action against this company? ( )Yes (x)No.

Explain: \_\_\_\_\_

Are you willing to sign an affidavit or testify regarding your transaction with this company? (x)Yes ( )No

Other governmental or regulatory agencies contacted: Az. State Banking Commission, Az. State Real Estate Commission, Az. State Attorney General.

May we send a copy of your complaint to another governmental agency or regulatory body for their review or investigation? ( )Yes ( )No

Do you know the names, telephone numbers and/or addresses of any other investors Yes. But I am reluctant to contact them about this complaint in view of the consequences it could have upon the Foundation.

Please explain the entire circumstances surrounding your complaint in the space provided below. If you need more space, attach another sheet of paper. It is important to include all details about the transaction, no matter how unimportant you may think they are. Please be specific in referring to any names, dates or documents. Also, if any part of the transaction occurred outside of Arizona, please indicate that fact. Remember, it is better to

include too much information, rather than too little information. Be sure to describe the type of investment and any instruments you received evidencing your investment.

See the four-page narrative attached.

The above is true and accurate to the best of my knowledge.

Signature David S. Moore Date: 7-10-92

(IF YOU WOULD ALSO LIKE TO FILE A COMPLAINT WITH THE BETTER BUSINESS BUREAU, CALL 264-1727)

Return completed form to: Securities Division  
Arizona Corporation Commission  
Attn: Bobby Ybarra  
1200 West Washington, Suite 201  
Phoenix, Arizona 85007

COMPLAINT FORM  
Attachment to Page 3  
David S. Moore  
July 10, 1992

Please read my attached correspondence to the Baptist Foundation of Arizona--especially that of February 10, 1992, and BFA's responses to me of April 13 and June 23, 1992. It all has to do with unsuccessful attempts to gain specific information about the Foundation that would help to measure the safety level of funds placed on deposit there.

Concerns over the safety of our deposits began about two years ago at a time when the aggregate amount was higher than it is now. At first, answers to questions were sought by phone from Foundation staff members in responsible positions, but were invariably referred to the president, William Crotts. Many of the answers that were received, in retrospect, were either incomplete or too vague. I then resorted to asking questions by letter, trusting that the written responses would be more thought-out and understandable. To date most all of the essential questions have been ignored by BFA. And contrary to Mr. Crotts' comment, none of the questions required the disclosure of information that could have been classified as being confidential to staff and board.

On January 18, 1991, the Foundation president and another officer elected to meet with my wife and me in Prescott to respond to questions raised in one of my letters about the 1989 audit, etc. That meeting did little to either convey information or calm my concerns. For one thing, I was told I could not see a financial statement on Arizona Southern Baptist New Church Ventures, Inc., the obligor with respect to funds we had placed with BFA.

More than a year later, and after examining BFA's more recent financial statement for the year ended 12-31-90, I wrote BFA again to express my concerns in a number of specific areas and asked questions about those areas. That February 10, 1992, letter was finally acknowledged by BFA on April 13. And while it did address several points of my letter, it answered only two of 19 questions. Those two involved BFA infractions concerning constitutional matters.

By any standards BFA is a large, southwest church financial organization. Its December 31, 1990, consolidated financial

statement--the last one made public to my knowledge--is  
synopsized as follows:

Total assets: \$79,793,850  
Total liabilities: \$78,292,302  
Net worth: \$1,501,548  
Gross income for the year: \$2,443,873  
Net income, after adding an extraordinary income item  
of \$6,904,926: \$1,256,610

Assets were centered primarily in real estate, \$21.4  
million, notes receivable \$43.3 million, and assets held in  
trust, \$5.5 million.

Liabilities were held largely in clients' deposit accounts  
of \$52.2 million, and notes payable of \$23.1 million.

Gross income was derived from its real estate activities,  
interest, and fee income.

These are my primary concerns for BFA and its operations.  
No effort has been made to rank them by order of importance:

1. BFA operations resemble that of a bank in that it  
accepts money on deposit subject to payment by some form of  
order or request. Yet, those whose millions of dollars are  
entrusted with it receive none of the safety benefits  
routinely received by bank clients. There is no deposit  
insurance. And of even greater concern is the absence of  
watchcare by any of the state and federal agencies that are  
charged with safeguarding banks.

Even though BFA operates under the graces of a charter  
granted by Arizona's Corporation Commission, it is highly  
unlikely that the Commission takes any periodic initiative  
aimed at overseeing the soundness of BFA's operating  
practices.

2. At 12-31-90, BFA was the holding company of a  
conglomeration of at least 12 wholly-owned subsidiaries. It  
also held general and limited partnership interests in at  
least ten organizations. It is apparently also involved to  
an unknown degree in other corporate activity that is not  
reported with its other financial statements. One such  
activity is Arizona Southern Baptist New Church Ventures,  
Inc.

Having many wholly-owned subsidiaries, as BFA has, can  
result in a financial jungle, in the darkened maze of which

problems of gargantuan proportions can be spawned and grown for years without detection by those having a need to know--especially in an unregulated environment. Two things would help to lessen this concern:

A. Reduce its corporations to three: one for taxable activity, one for activity that is non-taxable, and one for its trust activities. Each corporation could have the necessary number of divisions in order to segregate function.

B. In the absence of "A", publish its financial statement in "consolidating" format instead of the "consolidated" method now used. While this change in presentation would be a step forward, it would not eliminate other serious problems that can be staged within the structure of many related companies.

3. All BFA-originated references to its deposit accounts should include a clear announcement that the accounts are uninsured.

As additional protection for its depositors, its operating policy should include the regular periodic reporting of the manner in which deposit funds are invested. This reporting would need to be in sufficient detail so that a reader of average intelligence could form an opinion as to the risk level of his or her deposits.

4. BFA should publish and distribute to depositors on a quarterly basis an unaudited, brief-formatted financial statement including, at the least, a balance sheet and an operating statement for the three months then ended as well as year-to-date.

5. BFA should have an information center to where clients can direct their questions and concerns, and clients should be encouraged to freely use this service. It should not presume that its only accountability is to the board of directors, as is strongly suggested in its letter of April 13.

6. BFA's debt to "worth" ratio is high: \$78.3 million vs. \$1.3 million; i.e., for every \$1 of its own invested in the organization, creditors have invested \$62. This picture assumes that BFA's assets have been valued realistically. This disproportionate relationship means that there is little financial cushion in the event of any significant downturn in the economy.

Also, its liquidity appears too low when seen in the light of \$5.3 million in "current" debt against only \$2.7 million in "current" assets (cash).

In conclusion, others have also expressed concern about their funds on deposit with BFA.. Unfortunately, few of those have the ability to construct an appropriate question that encompasses the gist of their concern. And even though they were able to muster enough courage to reveal their concern, they most likely would not grasp the sufficiency or adequacy of the answer--provided one was given. Further compounding that scenario is the appearance that BFA discourages questions aimed at operational and financial matters wherein the answers have a direct bearing upon one's perception of the safety of money on deposit with it. Having been directly involved in funds management and control for many years, in my opinion that form of secrecy causes the soundness of BFA operations to be suspect and to require the intervention of The Arizona Corporation Commission in order to protect the interests of depositors.

## **EXHIBIT 2**

2ND STORY of Level 1 printed in FULL format.

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Phoenix New Times

December 10, 1998, Thursday

SECTION: Features

LENGTH: 4843 words

HEADLINE: Poring a Foundation;

State prosecutors, regulators scrutinize the Baptist Foundation of Arizona

BYLINE: Terry Greene Sterling

BODY:

The Baptist Foundation of Arizona recently proclaimed a banner financial year despite the fact that investigators from three different state agencies are scrutinizing the foundation's multimillion-dollar real estate and stock transactions with insiders, New Times has learned.

The Organized Crime and Fraud Section of the Arizona Attorney General's Office, with the assistance of the Securities Division of the Arizona Corporation Commission, is conducting a criminal investigation of certain BFA staffers and others involved in some of the complicated insider transactions, sources close to the investigation say. The insiders with whom the foundation has done business include one current and two former BFA board members.

New Times has confirmed that grand jury subpoenas have been issued in connection with the attorney general's investigation.

Investigators are working with former BFA staff accountants and a former staff attorney who quit the foundation in 1996 after warning top managers that their business dealings were unethical and possibly criminal.

"I am convinced that you honestly fail to appreciate the moral, economic and legal gravity of your actions," former BFA attorney L. Kyle Tresch wrote to his BFA superiors in a draft of his letter of resignation. The letter, which was obtained by New Times, goes on to say that BFA had for a decade engaged in transactions that amounted to "actionable fraud."

Former accountant Richard Polley wrote to BFA bosses that their business practices seemed intended "to deceive our investors regardless of the outcome to them. The Scriptures are quite clear that such an outcome is sin."

The Reverend W. Berry Norwood, chairman of the BFA board, dismisses the criticism, saying the former staffers "never had the information necessary to evaluate the transactions" and did not understand them.

The attorney general and Corporation Commission are not the only state agencies scrutinizing BFA. The Arizona Board of Accountancy is investigating Arthur Andersen LLP, a Big Five accounting firm with offices in Phoenix, to

determine if the firm followed acceptable accounting standards and principles when preparing BFA's audited financial statements.

No one has been charged with any crime in connection with any of the current state investigations, which were initiated following the publication of a New Times series detailing the findings of a six-month public records investigation of BFA.

The series revealed that BFA, a nonprofit corporation chartered in 1948 to help Southern Baptist causes, in 50 years had returned only \$1.3 million of its own money to the Southern Baptist community, yet lent nearly \$140 million to companies associated with current BFA director Dwain Hoover and former directors Jalma Hunsinger and Harold Friend. Much of the cash BFA funneled to insiders had come from church treasuries and the faithful, who have lent BFA more than \$317 million.

Although BFA says it has always repaid every penny to investors, public records raise serious questions about the true value of the real estate assets collateralizing some of those loans. BFA does not guarantee repayment of the loans (which are not federally insured), but relies instead on its position of trust in the Southern Baptist community to retain a steady stream of investors. BFA acts like a bank, borrowing money from investors and lending some of that money out for real estate projects. BFA's most recent audited statement reports that it has interest payments going out much faster than coming in: In 1997, interest-bearing liabilities totaled \$382 million, while interest-bearing assets totaled \$209 million.

Transactions between insiders and BFA are conducted through a web of at least 60 interlocking corporations, and many transactions were conducted without the knowledge of BFA's full board of directors. Such a complicated corporate structure and insider transactions are unusual for a religious foundation, officials of similar foundations say.

Five former BFA employees--four certified public accountants and one attorney--are assisting state investigators. All five resigned from BFA in 1996.

Their resignation letters and other internal documents obtained by New Times reveal that as early as 1996, BFA management was repeatedly warned by its own employees that, in their opinions, BFA management might be criminally liable for some of the complicated transactions.

A key question the state investigations may answer is whether illegal "self-dealing" occurred, whether transactions benefited insiders at BFA's expense. Self-dealing violates the Internal Revenue Code, fiduciary-duty laws, and fraud statutes. Penalties may range from revocation of tax-exempt status to criminal prosecution of officers and board members.

#### Attorney General's Investigation

Neither the Arizona Corporation Commission nor the Arizona Attorney General's Office will comment on the ongoing criminal investigation, which was confirmed to New Times through several knowledgeable sources, including BFA President Bill Crotts.

"As usual, we can't confirm or deny criminal investigations," says Karie

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Dozer, spokeswoman for the attorney general.

Dozer also declines to answer specific questions about the expected length of the probe, possible crimes that may have been committed or names of any individuals targeted in the investigation.

In general, explains Dozer, the Organized Crime and Fraud Section prosecutes fraud schemes and white-collar crimes. The Securities Division of the Arizona Corporation Commission has assistant attorneys general assigned to it, she adds, and investigates such crimes as the sale of unregistered securities and ponzi schemes.

In an October 30 letter to New Times, BFA President Bill Crotts confirmed the attorney general's investigation.

"The Baptist Foundation of Arizona welcomes investigation by the State," he wrote. "We have pledged our full cooperation to the State and, indeed, have already provided thousands of pages of documents. We welcome every opportunity to share with the state our 50-year history of growing an endowment that helps house, clothe, educate and feed children, the elderly and the needy."

In November, Crotts sent two communiques to investors and others in the state's Southern Baptist community confirming the attorney general's investigation. In both communiques, Crotts blamed the attorney general's criminal probe, which he identified as an "inquiry," on a "poorly written and poorly reported" series in New Times.

Crotts called the newspaper "quite anti-Christian."

"We have carefully examined the New Times articles about BFA," Crotts wrote. "They are vague and full of innuendoes. They clearly indicate that the reporter has an agenda to make the Baptist Foundation, certain benefactors and directors, our General Counsel Tom Grabinski and me look bad."

"We expected that state governmental authorities would, sooner or later, examine the articles. That day has come. The Office of the Arizona State Attorney General State has begun an inquiry that is based on the information reported in the New Times articles."

"You should be aware that when we learned the State was asking questions about us, we asked our attorneys to initiate contact with them. We told the State we would be happy to supply all of the information they wish and are now doing so."

"We welcome this inquiry because we want to set the record straight. The New Times has tried to damage our reputation and impede the Foundation's mission. This inquiry will finally bring this matter to a favorable end."

Officials of the Arizona Southern Baptist Convention, which nominates BFA's directors, did not respond to a fax and letter from New Times seeking comment on the investigation.

#### The Former Employees

In 1996, five employees of BFA--four certified public accountants and an

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attorney--began to question their superiors about the safety of millions of dollars of investors' money that BFA was plowing into real estate transactions, some of which did not seem ethical to the young professionals, all devoted Southern Baptists.

The attorney and two of the former accountants committed their concerns to paper, writing letters to their bosses complaining that the full BFA board and Arthur Andersen auditors did not know that BFA was hiding nonperforming loans worth millions of dollars by "selling" them to companies associated with insiders. The insider companies often wrote IOUs to BFA for the nonperforming loans. The loans were then hidden in the web of insider companies, and the insider IOUs, which were recorded as assets, had the effect of making BFA's books look artificially good, two of the employees wrote.

One letter alleges that BFA funneled \$2.2 million in Individual Retirement Account funds to a worthless insider company, which turned around and used the money to make a down payment to BFA so it could purchase the nonperforming loans from BFA.

The concept is called in accounting parlance "good bank-bad bank." According to documents written by some of the former employees, BFA played the good bank with an impressive balance sheet to show off to investors, while the insider companies played the bad bank by hiding BFA's nonperforming loans.

The accountants urged BFA to tell its auditor, Arthur Andersen, and the full BFA board that the bad banks were actually insider companies.

One insider company that worried the employees was former BFA director Jalma Hunsinger's ALO and its subsidiaries. In 1996, ALO reported that it was \$116 million in the red. That same year, ALO and its subsidiaries owed BFA \$58.2 million. The CPAs wondered how cash-poor ALO could ever pay BFA back. (According to BFA's most recent financial statement, ALO's debt to BFA has since increased to \$70.2 million.)

(When asked by New Times if Don Deardoff, a CPA who serves as BFA's controller, had a duty to advise BFA to ask Arthur Andersen to audit ALO, BFA board chairman W. Berry Norwood answers in his December 3 letter: "No.")

The employees also worried about the safety of millions of dollars in Individual Retirement Accounts to which BFA had access. Some of the IRA money was--still is--entrusted to Arizona Southern Baptist New Church Ventures (Ventures), which is managed by BFA. Ventures is a nonprofit company chartered in 1983 to help start new Southern Baptist churches. In a communique to the Arizona Southern Baptist community, Crotts noted that "as an IRA custodian, BFA allows investors to self-direct their investments to start up new churches." He said that Ventures in its history has lent more than \$22 million to 46 churches in Arizona. That's about \$1.5 million per year. What Crotts did not say in the communique is that Ventures also has lent millions to insiders for real estate transactions.

In response to a New Times letter seeking comment from Crotts, Grabinski and Don Deardoff, BFA's controller, the Reverend W. Berry Norwood, chairman of the BFA board, acknowledges in his December 3 letter that the Ventures board "invests its funds as it determines appropriate, including collateralized loans

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to ALO and other entities."

Crotts has said there is nothing wrong with such investments, because they are collateralized with real estate.

However, the staff CPAs and lawyer begged to differ. Dissatisfied with their superiors' assurances that nothing was amiss at BFA, they all resigned in 1996.

One of the first to quit was L. Kyle Tresch, an attorney licensed in Oklahoma and Arizona. Tresch had worked for BFA for only 17 months before he resigned in April 1996.

In a draft of his resignation letter addressed to Grabinski, Crotts and Deardoff, Tresch alleged "actionable fraud" had been going on for at least 10 years, and the three executives had put themselves in "a position of civil and criminal liability."

Tresch's primary concern was ALO, and the millions of dollars of BFA debt hidden in that particular "bad bank."

He wrote that he had voiced his concern with BFA executives--including Grabinski and Crotts--"about the large debt owed to BFA by ALO, and my concerns that the relationship between these entities had not been fully disclosed to either the Foundation Board of Directors or the Foundation's outside auditors."

According to Tresch, ALO's assets were "speculative," and interest ALO owed to BFA was "out of control."

Tresch acknowledged that just a few days before he wrote his letter, Crotts had told four BFA board members about the ALO problem, but Tresch indicated he did not trust that Crotts' disclosure was complete.

"Given the magnitude of the current problems, disclosure to any Board member that is not full disclosure could be more harmful than helpful," Tresch wrote.

"To the extent that you consider your position regarding BFA and ALO moral and justified, I am convinced that you honestly fail to appreciate the moral, economic and legal gravity of your actions," he wrote.

Tresch also chastised his bosses for "raiding IRA dollars" entrusted to Ventures to "facilitate the debt" of ALO.

"Legally, the current situation is fraught with liability," Tresch wrote. "Beginning with the first transfer of bad assets from BFA nearly ten years ago to a so called 'bad bank' which would not be audited but which you controlled through an outside party, there was actionable fraud. Each transfer of assets made to such off-balance sheet companies over the last ten years that was similarly made to improve BFA's balance sheet was likewise fraudulent. Not only have you placed yourselves in a position of civil and criminal liability for your actions, but you have likewise placed the auditors, directors and even innocent officers in positions of civil liability. After consulting with counsel, I have been advised that in fact I have a duty to ensure that the Board of Directors is informed about ALO and its relationship to BFA."

In closing, Tresch expressed his fear that the actions of BFA's executives

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would cast Southern Baptists and Christians in a bad light. He wrote: "My heart aches for my family, our churches, the reputation of Christians and Southern Baptists, the employees of BFA, the outside parties who have given credence to BFA without fully understanding the problem, and the many individuals who have invested millions of their hard-earned dollars with BFA."

After receiving the Tresch letter and hearing complaints from the accountants, Crotts did disclose the ALO debt to the full board in secret executive session. One board member tells New Times the "full board wasn't too upset" upon learning of the previously undisclosed loans to ALO. However, former board members say that once the scale of the ALO loans was disclosed, BFA directors ordered Crotts to work with a committee to approve subsequent investments.

Today, Tresch lives in Oklahoma. He declined an interview, explaining he cannot speak publicly about his tenure at BFA because he is "cooperating fully with the authorities in the ongoing investigations."

Richard Polley, BFA's trust accounting manager, was a friend of Tresch's. Just three weeks after Tresch resigned, Polley wrote a "for the file" memo blasting BFA for selling \$7.3 million worth of nonperforming loans to a shell company called East Valley Investment Group (EVIG), a company Polley noted had no assets. EVIG was solely owned by former BFA director E.A. Kuhn and was managed by BFA.

Kuhn had so little knowledge of the workings of EVIG that he said in a deposition this summer that he didn't even know where his own company did its banking. He testified that he left complete management of EVIG up to BFA.

In his May 1996 memo, Polley wrote that the EVIG deal was "deceptive," and noted that BFA had funneled \$2.2 million of IRA funds through a web of corporations to EVIG. The reason: The IRA dollars were used to make a "down payment" to BFA for the \$7.3 million nonperforming loans EVIG bought, he alleged.

Polley also wrote that the \$2.2 million in IRA funds had been shunted to EVIG without approval of the Ventures board of directors.

"Even if there are currently no church loans for which to use the money . . . I think most IRA investors in Ventures would be shocked to learn that their dollars were put to this use," Polley wrote.

"It appears the main motivation behind this transaction was to remove these notes from our books before the auditors required a writedown," the memo says. Polley added that ". . . BFA's investors stand to lose dollars unless the deficit problem is solved."

New Times asked BFA to comment on the Polley memo, and on June 30, Grabinski responded, "The East Valley Investment Group transaction described in the memo you provided has worked out as expected by all parties. The concerns in the May 9, 1996, Memorandum were unfounded."

Then, in a July 2 memo to the BFA board, Crotts and Grabinski made no mention of Polley's serious allegations--that IRA money was being misused and that BFA's

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nonperforming loans were being hidden in a shell company belonging to a former board member.

Instead, their memo to the BFA board confirmed the EVIG transaction had occurred in 1996. They wrote that "the original \$5.1 million promissory note, from EVIG to a BFA entity (Foundation Administrative Services, Inc.), has been paid down to approximately \$3.6 million, and the note is current. At the time of the transaction, staff felt the sale was a strong economic move, and their analysis has proven correct."

In August 1996, three months after writing the memo, Richard Polley resigned from BFA.

Polley noted in a letter to Crotts that he had met several times with Crotts and "always held out hope that you would begin to understand the enormity and severity" of the "good bank-bad bank" problem. The bad banks, according to Polley, were ALO and Ventures and their many subsidiaries. BFA was the good bank, "presenting good financial statements." This would amount to "assembling false and misleading financial statements," Polley wrote.

"As I stated in my earlier conversations with you, I believe that at its core this situation is a sin issue. I do not believe that our Lord and Savior, Jesus Christ, would have us conduct His business in a manner that withholds important information from our investors--information that might possibly change their decisions regarding investing with BFA. To have done so, and to continue to do so, is to deceive our investors regardless of the outcome to them. The Scriptures are quite clear that such an outcome is sin," wrote Polley.

Polley would not comment to New Times. He is reportedly cooperating with the state investigators.

In November 1996, three months after Polley resigned, Michael Maxson, also a CPA, quit BFA. In a letter to Crotts, Maxson wrote that he had met with BFA executives on several occasions and expressed his concern over the Ventures and ALO transactions.

Maxson wrote that he was so concerned about what was going on at BFA that he sought legal advice, "both civil and criminal."

"Although I have had no direct involvement in the transactions in question or the associated accounting for these transactions, I am being encouraged by all counsel to disclose this information to the appropriate authorities," Maxson wrote Crotts.

"To date, I have been reluctant to take this step because of the religious nature of this organization and the possible adverse consequences to new, as well as current investors. However, it appears that a systematic effort has been made to continue hiding this questionable activity as the dollars invested in BFA continue to grow. I believe that I have certain responsibilities professionally, ethically and morally to bring these unprofessional and criminal actions to light. I feel it would be in your best interests to come forward and, therefore, I must respectfully request that you contact the appropriate legal authorities, i.e. United States Attorney or Arizona Attorney General as soon as possible."

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Maxson would not comment for this story, and is reportedly cooperating with state investigators.

Two other CPAs--Karen Paetz and Steve Brock--also resigned from BFA in 1996. Sources say they, too, are cooperating with state investigators. Paetz could not be reached for comment; Brock lives in Oregon and would not comment for this story, citing the investigation.

In a December 3 letter responding to New Times' questions about the complaints voiced by former staffers, the Reverend W. Berry Norwood, BFA's board chairman, said that the full BFA board had seen the letters and memo written by Tresch, Polley and Maxson.

"The individuals upon whom you apparently rely never had the information necessary to evaluate the transactions, transactions in which they had limited involvement," Norwood wrote. "Perhaps it was lack of information or failure to understand the transactions that led some individuals to believe that there were 'ethical reasons' to resign that never existed."

#### Board of Accountancy Investigation

The state board that regulates CPAs is currently investigating Arthur Andersen LLP in connection with its preparation of BFA's audited financial statements, New Times has confirmed.

Because the state board operates in secrecy during the investigative process, Ruth Lee, executive director of the State Board of Accountancy, could not confirm or deny the probe.

"By statute, I'm not allowed to acknowledge whether an investigation is taking place," Lee says.

She will not disclose the names of the accountant or accountants being investigated, the reasons prompting the probe, or the expected length of the inquiry.

Arthur Andersen is an 85-year-old accounting firm that has expanded into a global business advisory company with 61,000 employees and \$6.1 billion in revenues for the fiscal year ending August 31.

In Phoenix, Arthur Andersen has audited BFA for at least 14 years.

A spokesperson at Arthur Andersen's Phoenix office would not answer questions about the state investigation but referred New Times to the firm's world headquarters in Chicago.

Jim Spangler, Arthur Andersen's chief spokesman in Chicago, also would not comment.

"My understanding is that the type of inquiry you're asking about is a confidential process until a final report is issued by the state board," Spangler said last week. "In honoring the spirit of that confidentiality process, we are prevented from either confirming or denying that there is such an inquiry."

The Arizona board, like all other state boards, tries to protect the public by ensuring that Arizona CPAs follow the standards and principles set forth by the American Institute of Certified Public Accountants (AICPA). The standards are complicated, but the bottom line is that all CPAs are professionally obligated to take extra steps to ensure that audited financial statements are not misleading or fraudulent.

The AICPA is so concerned about preventing white-collar crime that it recently issued a detailed primer of guidelines called "Consideration of Fraud in a Financial Statement," which is effective for all audits after December 15, 1997. The guidelines list risk factors for possible fraud that a CPA must take into account when conducting an audit. The risk factors don't necessarily mean that fraud is occurring, according to the AICPA, but they do indicate that the auditor must take extra steps to ensure that no fraud exists--steps such as ensuring that insider companies borrowing millions are fiscally sound, and that the collateral used for the loans to the audited company is legitimate.

Some of the risk factors for fraud listed by the AICPA include:

- \* An overly complex organizational structure with many legal entities.
- \* Difficulty in determining who, exactly, is in control of entities doing business with the audited company.
- \* Complex related party (insider) transactions with companies not audited or audited by a different firm.
- \* Adequate control over senior management by the board of directors and the internal auditing staff.

The standards are designed to help the auditor protect investors from bogus audited financial statements.

"If investors are duped by audited financial statements," says Tom Ray, of the AICPA's Audit and Attest Standards Committee in New York, "then auditors can be found culpable and have to pay the piper."

At the state level, paying the piper can range from revocation of a CPA's license to such mild disciplinary measures as ordering continuing education, says Lee, the executive director of the state board.

Arthur Andersen has tangled with the Accountancy Board before. In 1995, without admitting guilt, the firm paid \$562,000 to the Accountancy Board to settle allegations that in 1985 it misrepresented the financial status of Charles Keating's failed companies, American Continental Corporation and Lincoln Savings and Loan. Elderly investors had lost their life savings by purchasing American Continental junk bonds they thought were safe.

In 1994, Arthur Andersen paid \$1.3 million to the California Board of Accountancy to settle three cases, including the Lincoln Savings and Loan case.

In the courtroom, an accounting firm might be held liable for damages to investors if they made investments based on a misleading audited financial statement. Case in point: In 1992, Arthur Andersen, without admitting

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wrongdoing, agreed to pay elderly victims of Charles Keating's failed American Continental Corporation \$22 million in an out-of-court settlement. The victims had claimed, among other things, that the financial statements were misleading.

Spangler, Arthur Andersen's spokesman, will not comment on the out-of-court settlement, citing a confidentiality agreement. But Spangler confirms both settlements with the state boards. He notes that Arthur Andersen cooperated fully with both investigations. After the state probes were concluded, says Spangler, Arthur Andersen was "not found to have committed false or misleading financial reporting" in either case. He says the two boards did not sanction the firm, and did not place any restrictions on the firm's activities.

BFA would not comment on the Accountancy Board's current investigation of Arthur Andersen.

#### A Banner Year

In November, BFA President William P. Crotts addressed the annual convention of Arizona's Southern Baptists. He said this past year has been BFA's "very best year."

In two written communiques sent in November to BFA clients and the Southern Baptist community, Crotts painted a picture of a generous religious foundation dedicated to its ministry of helping Southern Baptist causes. For instance, he wrote that \$2.7 million worth of BFA's "expert staff time, talent and services" were donated in 1997 to Southern Baptist agencies, "entities" and churches. He claimed BFA recently forgave loans to the Southern Baptist community totaling about \$100,000. He said eight seniors came to know Christ in BFA's retirement centers.

The financial picture looked good, according to Crotts. He wrote that from October 1, 1966, to September 30, 1998 (32 years), trust funds managed by BFA had given a total of more than \$17 million to various charities. (He failed to note BFA itself had contributed only \$1.3 million of its own funds to charity in its 50-year history, or that its most recent audited financial statement indicates that BFA spent \$34.6 million in 1997 alone on salaries for its approximately 160 employees and for "general and administrative" expenses.)

Crotts noted that BFA by mid-November held investments totaling \$448 million. He noted that BFA had \$34 million in cash.

But a June 1998 "Offering Circular" issued by BFA paints a more modest picture and underscores the foundation's need to borrow more money, which troubled some of BFA's accountants as early as 1996.

In the circular, which states that BFA's net worth is \$12.4 million, BFA offers to borrow \$50 million through "Easy Access Investment Agreements"--term loans of \$50 or more with principal redeemed at any time. The collateral is not specified. The circular says it plans to "sell" the nonguaranteed notes predominantly to "members and constituents of Southern Baptist churches, their family members and friends as well as the churches themselves."

"Our investment results this year have been outstanding," Crotts wrote.

"These are wonderful days of blessing, but they have not come without attacks

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from Satan, our spiritual enemy," Crotts wrote. "I trust you will join me in seeing this as an assault on our common faith and begin to pray earnestly with me about it. Not only is this an assault on the values we as Christians hold dear, but I am also personally insulted because it totally mischaracterizes my 16 years of committed hard work at the Baptist Foundation of Arizona and BFA's 50 years of service to Arizona Southern Baptists."

Contact Terry Greene Sterling at 229-8437, or online at [tgreenefnewtimes.com](http://tgreenefnewtimes.com)

LOAD-DATE: December 9, 1998

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## EXHIBIT 3

1ST STORY of Level 1 printed in FULL format.

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THE ARIZONA REPUBLIC

October 13, 1999 Wednesday, Final Chaser

SECTION: FRONT; Pg. A16

LENGTH: 1285 words

HEADLINE: 1ST PROBE CAME UP EMPTY;  
NEW INVESTIGATION FINDS TROUBLESOME TRANSACTIONS

BYLINE: By Max Jarman, The Arizona Republic

BODY:

The Arizona Corporation Commission's securities division investigated the Baptist Foundation of Arizona from 1990 to 1993 and came up empty-handed.

Now, a year after joining a probe launched by the state Attorney General's Office, the division has uncovered at least a dozen fraudulent accounting transactions that call into question the soundness of the foundation and the safety of \$540 million invested with the foundation and its 50 affiliates.

"There are some kind of losses, but we're not sure how many," division director Mark Sendrow said. Estimates range from \$100 million to \$400 million for the foundation's 11,586 investors.

FOUNDATION HALTS SALES

On Aug. 11, the Baptist Foundation agreed to a Corporation Commission order to halt the sale of securities after the foundation was found to have made "material misrepresentations and omissions of material fact" in solicitations to potential investors.

But evidence shows the bogus accounting practices - similar to those used by Charles H Keating Jr. - that prompted the order have gone on for at least 10 years and were certainly taking place during the 1990-93 investigation.

That investigation was officially dropped in 1993 after concluding that the Baptist Foundation's investment solicitation brochures lacked proper disclosure. The division also decided it was powerless to enforce its disclosure and licensing rules because of a state exemption given to non-profit organizations.

Without the exemption, the foundation would have been required to file meticulous disclosure documents about its 50 or so securities offerings. In addition, members of its sales staff would have been required to hold a state securities license and pass a general competency test.

"We closed the case after making a recommendation to BFA regarding more thorough disclosure in the offering materials," Scott Wakefield, the securities division's attorney at the time, said in final report.

Sendrow said the foundation has complied with the suggestion and has produced more detailed disclosure materials.

He said the division closed the case in 1993 because it had received only one complaint from a disgruntled investor; the foundation's status as an

exempt issuer of securities; and the foundation's apparent disclosure of more information to prospective investors.

At the time, Sendrow said, the division trusted the competency of Jennings, Strauss and Salmon, the Phoenix law firm that prepared disclosure statements, and Arthur Andersen, an international public accounting firm that was auditing BFA's financial statements.

"More importantly, the division had no evidence in 1993 that BFA was engaging in the accounting fraud that the division has since uncovered, or that any funds had been misappropriated at that time," Sendrow said.

#### LOOKING FOR SOMETHING ELSE

Wakefield, the former securities division attorney, said the earlier investigation wasn't looking for the things that now are coming to light. Wakefield, now general counsel to the Residential Utility Consumer Office, said he remembers little of the earlier probe and can't comment because of the current investigation.

The questionable deals, being investigated by two Corporation Commission staff accountants and several temporary workers, involve the same type of scheme that helped send Keating to jail in 1992: selling real estate to a straw buyer for an inflated price, resulting in a paper profit.

Sendrow said the division is looking at a series of similar transactions at the Baptist Foundation that involve selling inflated real estate to an affiliated organization. Investigators believe the foundation often loaned the affiliate the money for a down payment and, in some cases, even kept the title, later using it as collateral for a loan based on the lower appraised value of the property.

The deals, which enabled the foundation to report a profit instead of a loss, occurred at regular intervals, generally near the end of the year, Sendrow said.

"The (Southern Baptist) church requires its affiliates to be self-supporting, and they took that as showing a profit each year," he said.

It appears some of the covered-up losses go back to the late 1980s and early 1990s, he said.

"It's surprising they didn't just work themselves out, given the comeback real estate has made," Sendrow said.

While Baptist Foundation was profiting from bogus land sales, the affiliated buyer was racking up huge losses.

One such company, A.L.O. Inc., had a negative net worth of \$116 million at the end of 1996, the last year companies were required to file annual financial reports with the Corporation Commission.

A.L.O. was organized in 1986 by foundation President William Crotts and now is headed by former board member Jalma Hunsinger.

#### LAW ALLOWS LESS SCRUTINY

A 1996 law, sponsored by then-state Sen. Carol Springer, now allows such organizations to operate with less public scrutiny. Springer, a Prescott Republican, now is state treasurer.

Sendrow, however, said the fraudulent land sales and cover-ups were such that they may not have been detected even if the Baptist Foundation wasn't exempt from the securities division's disclosure requirements.

"I hate to say it, if we didn't have any indication something was wrong, we wouldn't have known it," he said.

THE ARIZONA REPUBLIC, October 13, 1999

The current investigation is a result of several former foundation employees taking their concerns to the Attorney General's Office, as well as series of investigative stories in the New Times.

The division's earlier investigation looked into a complaint from David Moore of Prescott, who went to the Corporation Commission with his frustrations over the foundation's refusal to adequately answer questions about its finances.

In his 1992 formal complaint, Moore claimed to have bought \$7,360 worth of mortgage-backed notes from Arizona Southern Baptist New Church Ventures Inc., a foundation affiliate set up to raise money for church construction.

Moore said that Crofts refused to let him see a financial statement for New Church Ventures and that Crofts answered only two of 19 written questions he posed about the fund's financial condition.

In his complaint to the Corporation Commission, Moore said he was concerned that all the foundation subsidiaries could create a "financial jungle" in which problems could grow undetected. He also feared that some investors may assume their funds were secured and that the company's debt ratio at the time was too high.

#### CONCERNS VOICED IN 1992

In light of his 1992 complaint and the recent revelations about the foundation's fraudulent accounting practices, Moore understandably believes the Corporation Commission should have acted sooner than Aug. 11 to protect investors' capital.

"The concerns outlined in my complaint are identical to those finally becoming apparent now," he said.

In August, Moore wrote to Commissioners Jim Irvin and Bill Mundell and posed the same question; to this date, he has gotten no response.

Irvin was out of town and unavailable for comment, but Mundell said he didn't personally respond to Moore's letter because the securities division had done so.

Mundell said the blanket exemption from securities registration rules that is afforded to non-profit organizations concerns him. He favors reconsidering the exemption if it would prevent a situation similar to what has happened at the Baptist Foundation of Arizona.

LANGUAGE: ENGLISH

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